BLANK PAGE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 400

CONSOLIDATED ROCK PRODUCTS CO., a corporation, and EDWARD F. HATCH and LOUIS VAN GELDER, composing the Preferred Stockholders Committee of Consolidated Rock Products Co.,

Petitioners,

vs.

E. BLOIS DUBOIS, an objecting bondholder of record in the Plan of Reorganization,

Respondent.

Respondent's Brief on Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

KENNETH E. GRANT,
1215 Citizens National Bank Building, Los Angeles,
Attorney for Respondent.

MOTT AND GRANT,
JOHN G. MOTT,
HOWARD A. GRANT,
Of Counsel.

Parker & Baird Company, Law Printers, Los Angeles.

TABLE OF AUTHORITIES CITED.

CASES.

PAGE

Case v. Los Angeles Lumber Products Co., 308 U. S. 106 ..... 2, 3, 6, 12, 15, 16, 17, 20, 21, 22, 25, 27, 28

Du Bois v. Consolidated Rock Products Co., 107 Fed. (2d) 96 5

In re 620 Church Street Building Corporation et al., 299 U. S. 24 ..... 4, 15

Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U. S. 445 15

Louisville Joint Stock Bank v. Radford, 295 U. S. 555 ..... 14, 15

Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co., 174 U. S. 674 15

National Surety Co. v. Coriell, 289 U. S. 426 20

Northern Pacific Railway Co. v. Boyd, 228 U. S. 482 15

Railroad Retirement Board et al. v. Alton Railroad Co. et al., 295 U. S. 330 16

Sophian v. Congress Realty Co., 98 Fed. (2d) 499 23

Taylor v. Standard Gas & Electric Co., 306 U. S. 307 22

Wade v. Chicago, Springfield & St. Louis Railway Co., 149 U. S. 327 23

STATUTES.

Bankruptcy Act, Sec. 77B, 48 Stat. 912 (11 U. S. C. A., Sec. 207) 4

Judicial Code, Sec. 240a, as amended (28 U. S. C. A. 347 (a)) 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 400

CONSOLIDATED ROCK PRODUCTS CO., a corporation, and EDWARD F. HATCH and LOUIS VAN GELDER, composing the Preferred Stockholders Committee of Consolidated Rock Products Co.,

Petitioners,

vs.

E. BLOIS DUBOIS, an objecting bondholder of record in the Plan of Reorganization,

Respondent.

Respondent's Brief on Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

The petitioners, Consolidated Rock Products Co., a corporation, and Edward E. Hatch and Louis Van Gelder, constituting the Preferred Stockholders Committee of said corporation, seek review on certiorari of the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered on June 19, 1940 [R. 365-380]. Slight modification of the supporting opinion was ordered August 5, 1940 [R. 382-383].

The judgment and order have not yet appeared in the official reports.

Jurisdiction.

Petitioners invoke the jurisdiction of this Court under Section 240a of the Judicial Code, as amended (28 U. S. C. A. 347(a)).

Grounds on Which the Petitioners Seek Review.

Petitioners seek review by this Court on the following grounds:

1. Alleged error of the Circuit Court of Appeals in finding as a matter of law that the plan of reorganization involved is unfair and inequitable under the rule of *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, in the face of findings of (a) solvency of the debtor; (b) an equity in the stockholders, and (c) compromise of a *bona fide* dispute.

2. Alleged error of the Circuit Court of Appeals in finding as a matter of law that the plan of reorganization is unfair and inequitable under the "full priority" rule of *Case v. Los Angeles Lumber Products Co.*, because the two original bond issues involved are merged into one covering all properties of all companies.

3. Alleged error of the Circuit Court of Appeals in usurping the function of the District Court by finding the plan unfair and inequitable in the face of the findings of fact below.

4. That the judgment below presents a fundamental question of law applicable to numerous pending plans of reorganization of solvent corporations and is therefore of public importance.

At various points in the petition and brief the decision below is attacked by petitioners upon these further grounds:

1. Alleged erroneous application of the decision of this Court in *Case v. Los Angeles Lumber Products Co., supra,* in:

(a) Holding that a plan of reorganization of a solvent corporation is unfair as a matter of law if stockholders are permitted to salvage an existing equity;

(b) Holding that such a plan is unfair as a matter of law because stockholders of a corporation, upon the property of which there are no existing liens, are permitted to participate in the reorganization as a result of compromise of an alleged liability of the corporation to its subsidiaries, upon the properties of which are existing first mortgage liens;

(c) Holding that a plan of reorganization of a solvent corporation must be disapproved merely because, in the opinion of the Court, a controversy compromised as part of the plan was of little merit;

2. Alleged error of the Circuit Court of Appeals in applying the "fixed principle" of *Case v. Los Angeles Lumber Products Co., supra,* to the reorganization of a solvent corporation involving compromises between the interested parties.

3. Alleged error of the Circuit Court of Appeals in ignoring the District Court's findings of fact and substituting its judgment for the judgment of the interested parties, the special master and the District Court, result-

ing in a "shameful inequity" and a preference of the subsidiaries' bondholders over the stockholders of the solvent parent corporation, all contrary, petitioners assert, to the decision in *In re 620 Church Street Building Corporation, et al.*, 299 U. S. 24, 27.

4. The judgment if permitted to stand will effectually destroy all possibility of reorganizations under Section 77B of the Bankruptcy Act, even of solvent corporations, unless it conclusively appears from the record that creditors have been provided for in full before stockholders are permitted to participate, thus defeating the purpose of the enactment of Section 77B.

5. Purchase of his bonds by respondent, who alone appealed from the judgment of the District Court confirming the plan of reorganization, at depression prices far below the face value of the bonds.

Questions Presented.

The questions presented are indicated by the foregoing summary of petitioners' contentions.

Statute Involved.

The statute here involved is Section 77B of the Bankruptcy Act, 48 Stat. 912, 11 U. S. C. A. §207. Judgment of the trial court was entered prior to the effective date of the Chandler Act.

STATEMENT OF THE CASE.

1. The Proceedings Below.

The judgment complained of reversed the judgment of the District Court for the Southern District of California, Central Division, confirming a plan of reorganization involving Consolidated Rock Products Co. and its two subsidiaries, Union Rock Company and Consumers Rock and Gravel Company, Inc. For brevity, Consolidated Rock Products Co. will hereinafter be referred to as "Consolidated," Union Rock Company as "Union" and Consumers Rock and Gravel Company, Inc., as "Consumers."

The plan of reorganization was presented by Consolidated, the Union Bondholders' Protective Committee and the Consumers Bondholders' Protective Committee [R. 20]. Objections to the plan were filed by respondent. He owns First Mortgage Serial and Sinking Fund Gold Bonds of Union in the principal amount of $150,000, and First Mortgage Sinking Fund Gold Bonds of Consumers in the principal amount of $31,500 [R. 156]. The plan was confirmed on September 8, 1938, after hearings before a special master and the trial court [R. 231-265]. Respondent appealed to the United States Circuit Court of Appeals for the Ninth Circuit. That Court affirmed the judgment of the trial court on November 4, 1939, one judge dissenting. The decision, *Du Bois v. Consolidated Rock Products Co*, is reported in 107 Fed. (2d) 96.

Petition for rehearing was filed by respondent after decision by this Court in *Case v. Los Angeles Lumber Products Co., supra.* On February 19, 1940, the Circuit Court of Appeals vacated its decision, granted a rehearing, and directed the filing of further briefs [R. 363-364]. After submission of further briefs the decision of June 19, 1940, reversing the judgment of the District Court confirming the plan of reorganization, was entered.

2. The Relationship of the Corporations Involved in the Reorganization.

Consolidated was organized January 28, 1929 [R. 134]. It has no bonded indebtedness, but has issued and outstanding 285,947 shares of no par preferred stock, and 397,455 shares of no par common stock [R. 111].

In the year of its organization Consolidated purchased all outstanding stock of Union and Consumers, both of which were then important factors in the rock, sand and gravel industry of Southern California [R. 132-136]. Both Union and Consumers then had outstanding bond issues secured by trust indentures upon their respective properties [R. 134].

Consolidated by its purchase of the outstanding stock of Union also gained control of Reliance Rock Company, a wholly owned subsidiary of Union [R. 133, 160], as well as certain other of Union's wholly owned subsidiaries [R. 319].

After purchase of Union and Consumers by Consolidated an operating agreement was entered into by the

three companies, in which Reliance Rock Company, although a wholly owned subsidiary of Union, joined. The agreement bore date July 15, 1929, but was made effective as of April 1, 1929 [R. 160-175]. The purpose of this operating agreement apparently was to permit Consolidated to operate all the companies as a unit while each maintained its separate legal status. Under the agreement the subsidiaries transferred to Consolidated all of their cash, securities, notes and bills and accounts receivable, book accounts, manufactured materials and materials in process, raw materials not in place, supplies actually on hand and contracts for the sale of materials [R. 152], and gave Consolidated the full right to operate their plants and other properties [R. 165]. Consolidated agreed, among other things, to maintain the properties [R. 166], to keep full and complete accounts reflecting transactions between the companies [R. 167], to pay Union and Consumers from time to time all amounts necessary to comply with the provisions of their respective trust indentures [R. 167-168], and to pay all operating expense [R. 170-171]. Consolidated, in return was authorized by the operating agreement to retain for its own use and benefit all net revenue resulting from operation of the properties [R. 170-171].

After execution of this operating agreement Union, Reliance and Consumers ceased to exist as operating companies, and Consolidated assumed every function of management and ownership [R. 140-141].

A purported modification of the original operating agreement was entered into on February 16, 1933 [R.

176-182]. It was executed on behalf of Consolidated by its President, F. J. Tyaits, and its Secretary, Robert Mitchell, each of whom acted in the identical capacity for each of the subsidiary companies [R. 140-141].

Consolidated continued operation of all the companies under the operating agreement to the date of institution of proceedings for reorganization [R. 276]. Since then it has continued operation as a debtor left in possession.

Holders of common stock of Consolidated have no equity. This is tacitly conceded by the plan which permits their participation in the reorganization only upon further contribution [R. 31]. Absence of equity is further demonstrated by the valuation of $1.00 at which the total outstanding common stock is carried on the books of Consolidated [R. 314].

3. Summary of the Plan of Reorganization.

Briefly stated, the plan of reorganization [R. 20-65] contemplates a new corporation to which all properties of Union and Consumers, together with the allegedly free assets of Consolidated, will be transferred, discharged of all liens and claims. The new corporation will issue new 5% bonds, maturing 20 years after April 1, 1937, in the principal amount of $1,507,000, secured without distinction by lien upon all the properties transferred to it. The new bonds will be divided into Series U and Series C, comprising principal amounts of $938,500 and $568,500 respectively.

At the present time Union bonds in the principal amount of $1,979,500 remain outstanding, of which bonds in the

rincipal amount of $102,500 are held by Consolidated R. 189]. Consumers bonds in the principal amount of 1,200,500 remain outstanding at this time, of which onds in the principal amount of $63,500 are held by Consolidated [R. 189].

Under the plan present Union bondholders will receive new Series U bond in the principal amount of $500 for ach $1,000 in principal amount of present bonds held. Present Consumers bondholders will receive like distribution of the Series C bonds. The Union and Consumers onds held by Consolidated will be cancelled [R. 79].

The new corporation will also issue 30,140 shares of % preferred stock of the par value of $50 per share, ivided into Series U preferred stock of 18,770 shares nd Series C preferred stock of 11,370 shares. Present Union bondholders will receive 10 shares of the Series U preferred stock having a total par value of $500 for ach $1,000 in principal amount of present Union bonds eld. Present Consumers bondholders will receive like istribution of the Series C preferred stock [R. 28-30].

Series U and Series C preferred stock will be nonumulative until all new bonds of the corresponding series re retired [R. 47].

Both series of preferred stock will carry stock purchase arrants entitling holders to purchase common stock of he new company at $2.00 per share during a period of ix months, and at higher rates thereafter [R. 30].

The new corporation will issue 425,718 shares of comon stock, par value $2.00 per share. Of these shares of

common stock present preferred stockholders of Consolidated will receive 285,947, or one share for each share of present Consolidated preferred stock held by them. No payment of any kind is required of them. 60,280 shares of common stock will be reserved for issuance upon possible exercise of stock purchase warrants attached to new Series U and Series C preferred stock [R. 27].

Holders of the present common stock of Consolidated will receive stock purchase warrants entitling them at any time within three months after date to purchase one share of the new common stock for each five shares of present Consolidated common stock held, at a price of $1.00 per share [R. 31].

Not exceeding 50% of the "available net income" of the new corporation, as defined in the plan [R. 37-40], will be applied first to servicing the Series U bonds and preferred stock and meeting certain sinking fund requirements. The remaining 50% thereof will be applied to like purposes with respect to the Series C bonds and preferred stock. Any surplus net income will be available for general corporate purposes [R. 37; 47-49].

The plan makes no provision with respect to delinquent interest on the outstanding Union and Consumers bonds. It cancels all inter-company obligations [R. 28, 31]. The books of Consolidated show that corporation indebted to Union and Consumers under the operating agreement in an amount exceeding $5,000,000 [R. 281].

The effective date of the plan is fixed at April 1, 1937.

4. The Effect of the Plan.

From the foregoing it is seen that the plan accomplishes the following results:

(a) It destroys the liens securing the present Union and Consumers bonds and, without payment of such bonds, deprives the bondholders of their right of foreclosure;

(b) It deprives present Union and Consumers bondholders of 50% of their bond principal, substituting therefor a non-cumulative preferred stock;

(c) It cancels, without compensation, accrued bond interest amounting as of April 1, 1937, the effective date of the plan, to $659,690, and as of September 8, 1938, the date of confirmation by the District Court, to approximately $881,460;

(d) It reduces interest return to 41⅔% of that called for by the present bonds, and makes payment dependent on operating income, with default provisions so lenient that they are almost unconscionable [R. 39; 42-43].

(e) It effectively extends the time for payment of the present Union and Consumers bonds;

(f) It cancels inter-company obligations and thus relieves Consolidated of indebtedness to Union and Consumers in excess of $5,000,000, which constitutes part of the security for the present bonds [R. 300-302], or at least a fund to which bondholders might resort for full payment of their bonds and interest;

(g) It maintains the preferred stockholders of Consolidated in their present position of full equity ownership and in full control of the new corporation, without additional contribution or sacrifice of any kind on their part.

Summary of Argument.

Petitioners misconstrue the decision in the instant case as well as in *Case v. Los Angeles Lumber Products Co., supra.* Here the plan was properly disapproved because of plain violation of the full priority rule reannounced in the cited decision of this Court. The subsidiary corporations involved, Union and Consumers, are both insolvent. Yet their creditors are compelled by the plan to share their insufficient assets with stockholders of Consolidated. The contention that the full priority rule is not applicable because of solvency of the united enterprise is entirely beside the point and without merit in any event.

None of the reasons presented by petitioners in justification of the plan permit the full priority rule to be disregarded.

The decision of the Circuit Court of Appeals properly applies the rule in holding, as a matter of law, that the plan is unfair. 'No findings of fact of the District Court were improperly set aside.'

The decision, properly construed, does not prevent substitution of a common issue of bonds for the present Union and Consumers issues.

No case for exercise of the jurisdiction of this Court is made out by the petition.

ARGUMENT.

1. Petitioners' Misconception of the Decision of the Circuit Court of Appeals.

The petition and supporting brief misconstrue and distort the decision complained of. The decision does not declare the plan of reorganization unfair and inequitable because thereunder stockholders of Consolidated are permitted to salvage an existing equity, or because such stockholders are allowed participation as the result of compromise of an alleged liability of Consolidated to its subsidiaries, or because, in the opinion of the court, a compromise of a controversy of little merit is involved in the plan. Nor is the plan declared unfair and inequitable because the outstanding Union and Consumers bond issues are thereunder replaced by a new common issue of bonds.

Petitioners' assertions to the contrary are without foundation.

A reading of the decision discloses that the plan was declared unfair and inequitable for one reason alone, namely: that it fails to accord full priority to Union and Consumers bondholders and, on the contrary, compels them to share with stockholders of Consolidated the already insufficient assets to which they are entitled to look for payment of their bonds.

The correctness of the Court's decision is easily demonstrated. As it points out, the assets of Union and Consumers securing their respective bond issues are insufficient in each case to discharge the bonds and accrued interest [R. 377]. All assets of both companies secure

their respective bonds [R. 301-302]. Both Union and Consumers then are insolvent.

However, their combined assets have a value of $3,300,000,[1] while the principal amount of bonds held by the public is only $3,014,000 [R. 240-241]. Consequently there are assets of the value of $286,000 available for discharge of accrued interest after all principal obligations have been met.

That the plan seriously invades the property rights of the Union and Consumers bondholders is apparent. *Louisville Joint Stock Bank v. Radford,* 295 U. S. 555. Accrued interest is cancelled although assets are available to discharge it in part; bond principal is reduced by 50% although secured in full; bondholders are compelled to accept a non-cumulative preferred stock in lieu of the 50% of bond principal taken from them; their interest return is reduced to 41⅔% of that called for by the present bonds and is made payable on an income basis; the time for payment of the bonded indebtedness is extended; certainty of future regularity in servicing of the new bonds is jeopardized by lenient default clauses in the indenture.

While bondholders of Union and Consumers are so treated, the present holders of preferred stock of Consolidated exchange their stock for the common stock of the new company, share for share, and without additional contribution to the reorganized enterprise. Today all equity after recognition of bondholders is lodged in these preferred stockholders of Consolidated; tomorrow, if the plan is confirmed, all equity in the reorganized enterprise

---

[1]The special master did not report separately as to the value of Union and Consumers assets. The value of $3,300,000 includes the assets of Reliance Rock Co. These are properly included as that Company is a wholly owned subsidiary of Union.

will also be lodged in them except as bondholders and present holders of common stock of Consolidated may acquire new common stock by purchase.

In other words, holders of the preferred stock of Consolidated maintain their present position. Only the evidence of their ownership of the equity is changed. But their equity position is strengthened and the value of their equity is enhanced by each step in the drastic treatment of Union and Consumers bondholders outlined in the plan. What is taken from bondholders is in effect given to present holders of preferred stock of Consolidated; they benefit in direct proportion to the extent that bondholders' property rights are invaded.

The plan does not recognize the rule of *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U. S. 445, 455, that "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation." It ignores the "familiar rule" reaffirmed by *Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co.*, 174 U. S. 674, 684, that "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors." Its effort to compel bondholders "to share the already insufficient assets with stockholders" merits only the condemnation voiced in *In re 620 Church St. Corp.*, 299 U. S. 24, in *Northern Pacific Railway Co. v. Boyd*, 228 U. S. 482, in *Case v. Los Angeles Lumber Products Co., supra*, and in the long line of cases cited by this Court in its last mentioned decision.

The invasion of the property rights of the bondholders to benefit stockholders of Consolidated is in violation of the Fifth Amendment. *Louisville Joint Stock Bank v.*

Radford, supra; Railroad Retirement Board, et al. v Alton Railroad Co., et al., 295 U. S. 330, 357.

Petitioners' misconception of the decision of the Circuit Court of Appeals is further emphasized by their assertion that it gives the Union and Consumers bondholders "the prior position against all the property of the subsidiaries *and Consolidated.*"

The declaration is without foundation. The Court merely found the plan to be unfair and inequitable. That conclusion of law was based entirely on the diversion to Consolidated's stockholders of property of the insolvent Union and Consumers as to which bondholders of those two corporations are entitled to full priority.

2. Petitioners' Misconception of the Rule of Case v. Los Angeles Lumber Products Co

Petitioners devote some six pages of their brief to a comparison of the facts of this case and those presented by *Case v. Los Angeles Lumber Products Co.; supra.*

The importance here of *Case v. Los Angeles Lumber Products Co.* lies not so much in the similarity of the facts presented in the two cases, but rather in its unequivocal declaration that reorganization proceedings under the Bankruptcy Act must be governed by the "full priority" rule of the cases above cited, and in its reiteration of judicial condemnation of "any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of creditors, . . ."

Petitioners make no attack upon the "fixed principle." They contend, however, that it is applicable only in the reorganization of an insolvent corporation. They point

out the finding of the District Court that while Union and Consumers are insolvent, the united enterprise—Consolidated considered with the two subsidiaries—is solvent. The argument overlooks the fact that it is the properties of the insolvent Union and Consumers which are diverted from creditors to stockholders, and that it is for this reason the plan must meet with judicial condemnation.

But regardless of its irrelevancy, petitioners' doctrine is a novel one. Stated in other words, it would compel an insolvent debtor to relinquish all of its property to its creditors; *a solvent debtor, however*, having the ability to discharge its debts in full, would be permitted to bind all creditors by any arrangement, regardless of its fairness, which the debtor could persuade two-thirds of its creditors to accept.

Language of *Case v. Los Angeles Lumber Products Co., supra,* is given by petitioners in support of their novel doctrine. No other authority is presented. In the cited case the debtor corporation was insolvent not only in the equity sense, but in the bankruptcy sense as well. So are Union and Consumers here. The language of the cited decision is naturally tied definitely to the facts which this Court had before it. There is nothing in the language, however, which remotely suggests that a solvent corporation in reorganization is to be granted immunity from the fixed principle of full priority of creditors.

Petitioners' doctrine is not supported by the cases. It is obviously devoid of logic.

Petitioners repeatedly reiterate that Consolidated and the enterprise as a whole are solvent, that there are no liens against the properties of Consolidated, and that Consolidated did not assume payment of the Union and Consumers bonds when it acquired the stock of those com-

panies. They fail to point out, however, how these facts can justify an appropriation of property upon which the bondholders have a mortgage lien for the benefit of holders of the preferred stock of Consolidated.

3. The Compromise Referred to by Petitioners as Justification of the Plan.

It is argued by petitioners that the plan of reorganization should have been upheld because in it is involved a compromise of a disputed liability of Consolidated to Union and Consumers. No details are given for the information of the Court.

Reference is apparently made to the provisions of the plan cancelling all inter-company obligations [R. 26; 32], and the further provisions cancelling Union bonds in the amount of $102,500, and Consumers bonds in the amount of $63,500, owned by Consolidated [R. 55]. Full records were kept reflecting accounts between Consolidated and the subsidiaries under the operating agreement of 1929 [R. 280-281]. They show Consolidated indebted to the subsidiaries in the sum of $5,727,939.09, against which there is a set-off of $540,707.58 [R. 281]. Adding to this latter amount the $166,000 representing the face value of subsidiary bonds owned by Consolidated, that corporation is still indebted to Union and Consumers, after all set-offs, in an amount exceeding $5,000,000.

The plan called attention to the cancellation of bonds owned by Consolidated. No mention was made, however, of any compromise through which Consolidated rid itself of the staggering indebtedness to the subsidiaries.

Throughout these proceedings respondent has attacked the cancellation of this indebtedness. He has contended that under the after-acquired property clauses of the Union and Consumers indentures [R. 301-302] the indebtedness was part of the security behind the bonds, or at least a fund which could be reached by the bondholders if deficiencies resulted upon foreclosure sale of the properties admittedly subject to the indentures. He has contended further that if the assets of Consolidated were applied to payment of the indebtedness owing to Union and Consumers the bondholders of the subsidiaries could be paid in full, both interest and principal, while Consolidated would be stripped to a point where its contribution to any reorganization would be infinitesimal at the most.

Respondent does not feel that the Court need be bothered with discussion of this controversy. Petitioners do not attempt to explain how the tremendous advantage gained by Consolidated through cancellation of the inter-company obligations can be urged in justification of the plan's further invasion of the already insufficient properties to which Union and Consumers bondholders admittedly are entitled to look for payment of their bonds. Assuming that cancellation of the inter-company obligations is entirely proper, bondholders are nevertheless entitled to full priority as to the Union and Consumers properties remaining. The plan does not accord them this priority.

The Circuit Court of Appeals in its decision pointed out the necessity for some determination of the controversy. However, it declared the plan in violation of the full priority rule entirely independent of any consideration of the plan's cancellation of inter-company obligations.

4. Miscellaneous Considerations Advanced by Petitioners as Justifying the Plan.

Certain additional reasons are given by petitioners to support their contention that the Circuit Court of Appeals should not have disapproved the plan. It is argued that the District Court exercised that informed and independent judgment required by *National Surety Co. v. Coriell*, 289 U. S. 426, and *Case v. Los Angeles Lumber Products Co., supra.* Reference is made to the long period of time which elapsed between the filing of the petition under §77B and the confirmation of the plan by the District Court. The argument assumes that time is the essence of informed and independent judicial judgment. It leads petitioners to the absurd conclusion that judicial error should be overlooked if it occurs despite diligent and sincere judicial effort.

Petitioners also seek to justify the plan because of (1) Consolidated's solvency and absence of liens against its properties; (2) purchase by holders of preferred stock of Consolidated of their stock for $7,000,000 and without prior claims; (3) the occurrence of violent disputes between the two bondholder groups, and between both groups and Consolidated; (4) the necessity of legal determination of rights as between the two bondholder groups; (5) repeated threats of litigation; (6) the necessity of foreclosure under the trust indentures and establishing of deficiencies before the bondholders could assert any claim against Consolidated under the operating agreement; (7) the express provision of the operating agreement that it was not made for the benefit of third parties; (8) protracted negotiations leading up to the submission of the plan; (9) approval of the plan by the requisite majorities.

Respondent has briefly discussed the first of the above grounds in his discussion of petitioners' misconception of the rule of *Case v. Los Angeles Lumber Products Co., supra.* The second ground is equally irrelevant.

Disputes did occur between the Union and Consumers bondholders with respect to division of income between them in any new corporation. The delay in formulating a plan resulted primarily from these disputes [R. 273-274]. This fact might be of importance in considering the fairness of the plan from the standpoint of any preference of one bondholder group over the other; it is irrelevant when a plan has been condemned because it diverts to stockholders property as to which all bondholders are entitled to full priority.

No one denies that Consolidated threatened litigation unless it was relieved of its $5,000,000 indebtedness to the subsidiaries under the operating agreement [R. 275-276]. The nature of its position is indicated by the lack of merit in the defenses it alleged [R. 276]. The following language of this Court in *Case v. Los Angeles Lumber Products, supra,* is peculiarly applicable:

> "The conclusion of the District Court that avoidance of litigation with the stockholders gave validity to their claim for recognition in the plan involves a misconception of the duties and responsibilities of the court in these proceedings. Whatever might be the strategic or nuisance value of such parties outside of §77B is irrelevant to the duties of the court in confirming or disapproving a plan under that section. In these proceedings there is no occasion for the court to yield to such pressures. If the priorities of creditors which the law protects are not to be diluted, it is the clear duty of the court to resist all such assertions." [Pages 129-30.]

However, as previously stated, the plan was condemned for reasons entirely apart from the problems involved in a consideration of the rights and liabilities of the parties to the operating agreement. Consequently petitioners' sixth and seventh grounds listed above are irrelevant to a consideration of the petition here.

The eighth and ninth grounds given for justifying the plan are equally unimportant. Protracted negotiations prior to submission of a plan are no guarantee of fairness; nor does approval by the requisite majorities of interested parties protect an unfair plan from judicial denunciation. *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307; *Case v. Los Angeles Lumber Products Co., supra.*

None of the grounds stated by petitioners, nor all of them taken together, can justify the plan. They do not even measure up to the "ephemeral" value of the select group from the "host of intangibles" which this Court repudiated in *Case v. Los Angeles Lumber Products, supra.*

5. Respondent's Status As An Objector to the Plan of Reorganization.

Petitioners contend that the judgment below should not be permitted to stand "for equitable reasons." The "equitable reason" given is that respondent purchased his Union and Consumers bonds during the dark days of depression and at depreciated prices. For this petitioners stigmatize him as a greedy speculator. They picture him as an obstructionist because he has opposed the plan of reorganization here involved as unfair. Certainly no step has been taken by respondent in these proceedings which has been improper. The position taken by him from the outset has now been upheld by the Circuit Court of Appeals.

The consideration paid by respondent for his bonds is wholly immaterial in determining whether the plan is fair and equitable. *Wade v. Chicago, Springfield & St. Louis Railway Co.*, 149 U. S. 327, 343.

If the plan here is fair, equitable and not discriminatory, it should of course be confirmed; but petitioners by innuendo urge that the plan regardless of its fairness should be confirmed simply because respondent alone has attacked it on appeal.

Long before the filing of any petition under Section 77B, respondent began the purchase of his bonds. The petition was filed May 24, 1935 [R. 267]. All respondent's $31,500 of Consumers bonds were acquired between July 1, 1934, and April 17, 1935. When the petition was filed he was one of the large holders of Consumers bonds [R. 297].

Between September 20, 1934, and May 8, 1935, respondent acquired $72,000 of Union bonds. Thereafter down to December 9, 1935, he purchased $78,000 more of Union bonds [R. 297]. The plan of reorganization was not presented to the lower court until after March 15, 1937, more than two years after respondent had become a substantial bondholder.

In this connection an observation worthy of note was made by the Court in the case of *Sophian v. Congress Realty Co.*, 98 Fed. (2d) 499, 502, when it said:

> "In many reorganization proceedings such as this, the rights of small, scattered and thoroughly discouraged bondholders are involved. Often they are unable to employ counsel to protect their rights. It is of great importance that the courts of bankruptcy shall see to it that they are not unfairly dealt with."

The observation has peculiar application here. Respondent is by far the largest individual owner of Union bonds. These bonds are scattered among some 650 bondholders. The average holding is between $2,500 and $3,000 in principal amount [R. 296]. The average holding of Consumers bonds is approximately $3,000 in principal amount [R. 294].

The proceedings herein have extended over a period of years. Two years elapsed before Consolidated and the Bondholders Protective Committees presented a plan. The judgment confirming the plan was not entered until September 8, 1938. It is not difficult to realize the discouraging effect of such delay upon small and scattered bondholders. In large measure respondent has borne the brunt of battle for all bondholders who could pursue no other course than to approve any plan presented after interminable delay. In some measure, it may be justly said, respondent has aided in making certain that assets belonging to creditors are not, by indirection, diverted to stockholders.

6. The Alleged Usurpation by the Circuit Court of Appeals of the Function of the Trial Court.

Petitioners assert that the decision below improperly set aside the findings of fact of the District Court. They brand this as a usurpation by the Circuit Court of Appeals of the function of the District Court as a trier of facts.

What findings of fact were disturbed on appeal is not pointed out with certainty. Petitioners probably have reference to the findings dealing with solvency of the united enterprise and "compromise" of Consolidated's liability under the operating agreement. They cannot have

in mind the finding of the District Court that the plan was fair and equitable, for that of course presents a question of law. *Case v. Los Angeles Lumber Products Co., supra.*

Having found the plan to be in violation of the full priority rule, and so unfair as a matter of law, the Circuit Court of Appeals did express its dissatisfaction with the condition of the record with respect to the value of properties of the various corporations involved. It made clear that in the face of the uncertainty appearing it was impossible to determine what participation, if any, the holders of the preferred stock of Consolidated are entitled to be given in any reorganization. This was in response to respondent's contention that insolvency of the united enterprise was established by the weight of the evidence [R. 282-283] and by the special master's specific findings [R. 151]. Respondent's twelfth, thirteenth and eighteenth assignments of error attacked all findings dealing with the value of Consolidated's assets and the existence of any equity in that corporation [R. 334-335; 336: 341].

Nor is the Court's comment on the necessity of some determination of the rights and liabilities of the parties to the operating agreement improper. This responds directly to respondent's fourteenth, sixteenth and seventeenth assignments of error attacking failure of the special master to pass upon the issues raised as to the operating agreement [R. 337-338; 339-341]. The decision below, however, repudiates no finding of the District Court on this point for no finding was made. The general narrative statement that the plan was evolved after "efforts on the part of all three of the warring factions to compromise" their differences is not a finding that the subsidiaries in fact ever arrived at an agreement

with Consolidated with respect to the operating agreement [R. 244]. If it can be construed as a finding it was made by the District Court without evidence, and in face of its confirmation of the special master's report ignoring the point [R. 261].

But again we are dealing with inconsequential matters. Petitioners' contentions here do not bear on the crux of the case. They have no reference to the fixed principle of full priority. They do not justify the plan's confiscation of bondholders' property for the benefit of stockholders of Consolidated.

7. Substitution of a Common Issue of Bonds in Lieu of the Outstanding Union and Consumers Bonds.

Petitioners attack the decision on the ground that it makes impossible any reorganization under which separate and distinct issues of bonds are eliminated and replaced by one issue in which there is common participation. In the instant case the plan eliminates the outstanding Union and Consumers bonds, commingles all properties of both companies, and provides for a single issue of new bonds for issuance to Union and Consumers bondholders. It is contended that the decision of the Circuit Court of Appeals condemned the plan as unfair because of this.

Reference is made to the language of the Court reading as follows:

> "It is obvious that the plan here is condemned by these rules. The trial court found that the property of Union covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Union, yet the Union bondholders

are deprived of their right to full priority against Union's assets, *since Consumers' bondholders* and debtor's preferred stockholders are given an interest in Union's property. Likewise, the trial court found that the property of Consumers covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Consumers, yet Consumers' bondholders are deprived of their right to full priority against Consumers' assets, *since Union's bondholders* and debtor's preferred stockholders are given an interest in Consumers' property." [R. 377; italics ours.]

Respondent feels that the inclusion of the italicized words was unnecessary. He joined with all other parties in moving that they be stricken. The motion to strike was denied. From this it must be concluded that the Circuit Court of Appeals felt the parties were unduly apprehensive that an unwarranted construction could be placed upon the language used.

The portion of the Court's decision quoted follows immediately after a discussion of the law of *Case v. Los Angeles Lumber Products Co., supra.* The Court goes on to point out that although both Union and Consumers are insolvent, their properties are shared in under the plan by persons other than their respective creditors. Respondent is of the opinion that the Court, in using the language it did, intended only to emphasize the plain violation of the "full priority" rule It should not be construed as a pronouncement of law that the outstanding Union and Consumers bonds cannot be replaced by a new issue in which both groups of bondholders participate jointly.

Respondent has never contended and does not now contend that under Section 77B it would be improper to eliminate the present Union and Consumers bonds and replace them by a common issue. He has attacked the division of income between Series U and Series C bonds under the plan as unfair to Union bondholders. His attack has gone no further.

The bondholders' committees of Union and Consumers have filed independent petitions seeking correction of the decision in this respect only. Respondent does not oppose such correction if this Court deems it necessary, although as indicated above he does not believe that the language of the Court, properly construed, establishes a rule of law.

Conclusion.

In concluding this brief respondent submits that the decision of the Circuit Court of Appeals is correct and that disapproval of the plan of reorganization here involved was compelled by *Case v. Los Angeles Lumber Products Co., supra,* and the earlier decisions of this Court pertaining to equity reorganizations. Petitioners have failed to show cause for the exercise of jurisdiction by this Court.

Respectfully submitted,

KENNETH E. GRANT,
Attorney for Respondent.

MOTT AND GRANT,
JOHN G. MOTT,
HOWARD A. GRANT,
Of Counsel.

BLANK PAGE